STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/25/02**	Bill No:	**AB 2878**
Tax:	**Bradley-Burns**	Author:	**Wiggins**
Board Position:		Related Bills:	**AB 680 (Steinberg)**

BILL SUMMARY

Among its provisions, this bill would modify the property tax allocation to a city or county, provide that a city may not impose a sales and use tax rate in excess of 0.85% except under specified circumstances, and prohibit the state from transferring money from the General Fund to cities and counties to fund vehicle license fee offsets.

Although this bill deals with property tax, sales and use tax, and vehicle license fees, this analysis will deal primarily with the sales and use tax provisions. The other areas will be discussed generally only because they are related to the sales tax provisions in this bill, but they are not within the scope of administration by the Board.

ANALYSIS

Current Law

Property Tax

Prior to Proposition 13, each local government with taxing powers (counties, cities, schools, and special districts, etc.) could levy a property tax on the property located within its boundaries. Each jurisdiction determined its tax rate independently (within certain statutory restrictions) and the statewide average tax rate prior to Proposition 13, under this system, was 2.67 percent. After Proposition 13, the property tax rate was limited to a maximum of one percent of a property's assessed value.

Since local jurisdictions could no longer set their own individual tax rates and instead were required to share in a pro rata portion of the maximum one percent tax rate, the Legislature was given the authority to determine how the property tax revenue proceeds should be allocated. The legislation that established the current property tax allocation system, found in Revenue & Taxation Code §95 - §99.2, was Assembly Bill 8 (Stats. 1979, Ch. 282, L. Greene). The descriptive term for the allocation procedure for locally assessed property tax revenues is still commonly referred to as "AB 8," some twenty years later.

In addition to establishing allocation procedures, AB 8 also provided financial relief to local agencies to offset most of the property tax revenue losses incurred after Proposition 13. AB 8 provided relief in two ways: first, it reduced certain county health and welfare program costs and, second, it shifted property taxes from schools to cities, counties and special districts, replacing the school's lost revenues with increased General Fund revenues. (There were six counties - Alpine, Lassen, Mariposa, Plumas, Stanislaus, and Trinity – referred to as "negative bailout" counties, where the amount of property taxes allocated to the county was *reduced* because the health and welfare components of AB 8 were so favorable to those counties.)

In 1992, the Educational Revenue Augmentation Fund (ERAF), was established. ERAF partially reversed the relief provided to local agencies by AB 8. The effect of ERAF was to redirect a portion of property tax revenues previously allocated to cities, counties, and special districts to schools, thus reducing the state's General Fund obligations for funding schools under Proposition 98.

Vehicle License Fee

The vehicle license fee (VLF) is an annual fee on the ownership of a registered vehicle in California, in lieu of a personal property tax. The fee is calculated based on 2 percent of the market value of the vehicle. This amount is offset by 67.5 percent of the fee for vehicles registered after July 1, 2001. The California Constitution requires that revenues generated from the annual vehicle license fee be allocated to cities and counties. The VLF law provides that money from the General Fund be transferred to cities and counties to compensate for reduced revenues resulting from VLF offsets.

Sales and Use Tax

The Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with Section 7200 of the Revenue and Taxation Code) authorizes counties to impose a local sales and use tax. The rate of tax is fixed at 1¼ percent of the sales price of tangible personal property sold at retail in the county, or purchased outside the county for use in the county. All counties within California have adopted ordinances under the terms of the Bradley-Burns Law.

Under the Bradley-Burns Law, the ¼ percent tax rate is earmarked for county transportation purposes, and 1 percent may be used for general purposes. Cities are authorized to impose a sales and use tax rate of up to 1 percent, which is credited against the county rate so that the combined local tax rate under the Bradley-Burns Law does not exceed 1¼ percent.

The 1¼ percent tax is collected by the Board, primarily from remittances by retailers. The Board currently allocates the tax to cities and counties primarily based on the retailer's place of business (i.e., situs method of allocation).

Proposed Law

This bill would add Section 11000.2 to the Revenue and Taxation Code to provide that, on and after July 1, 2002, the state may not transfer any money from the General Fund to fund VLF offsets.

This bill would add Section 96.11 to the Revenue and Taxation Code to modify the formula used to allocate property tax revenues. This bill would increase the amount of property tax allocated to a city or county to offset the amount lost due to elimination of the VLF offset payments. To offset the allocation increase to a city or county, the allocation to a school district would be decreased.

This bill would also increase the amount of property tax revenue allocated to a city to offset the cities decrease in local sales and use tax revenue. To offset the allocation increase to a city, the property tax allocation to the county in which the city resides would be decreased accordingly.

This bill would amend Section 7202 to provide that the maximum sales and use tax rate a city may impose (which is offset against the county-wide rate of 1.25 percent) shall be determined pursuant to Section 7202.1. New Section 7202.1 would provide that the maximum sales and use tax rate a city may impose shall be 0.85 percent, except under the following circumstances: A city may impose a rate greater than 0.85 percent if the additional property tax allocated to a city is insufficient to offset the loss of local sales and use tax due to the new 0.85 percent rate.

This bill would require the Department of Finance to make the necessary calculations with respect to the property tax allocations, VLF offsets, and sales and use tax revenues on or before October 1, 2002.

This bill contains an urgency clause and would become operative immediately.

The following tables are provided to help illustrate how the provisions of this bill would affect the revenue of a fictitious city and county.

Table 1 illustrates the various increases and decreases in revenue for a city, county, and the state general fund as a result of each provision of this bill.

Table 1		
City	**County**	**State General Fund**
Decrease in revenue due to lack of vlf offset payments received	Decrease in revenue due to lack of vlf offset payments received	Increase in revenue due to elimination of vlf offset payments to cities and counties
Increase in property tax revenue to offset amount lost due lack of vlf offset payments received	Increase in property tax revenue to offset amount lost due to lack of vlf offset payments received	Decrease in revenue due to additional funding required for schools due to property tax shift from schools to cities and counties
Increase in property tax revenue to offset decrease in local sales tax revenue	Decrease in property tax revenue to offset increase in local sales tax revenue	no change
Decrease in sales tax revenue to offset increase in property tax revenue	Increase in sales tax revenue to offset decrease in property tax revenue	no change

Table 2 and Table 3 are provided as an example to illustrate the shift in the sources of funding for a fictitious city and county. Shown are the various sources of revenue, the amount of revenue received under the current law, the shift in revenue proposed by this bill, and the proposed revenue to be received by the city and county based on the provisions in this bill. In this example, the fictitious city is located within the fictitious county to help illustrate how revenue would shift between the city and county. Within the city and county, there are essentially two revenue shifts (shown separately). The first shift in revenue occurs when a city or county does not get a vlf offset payment but gets additional property tax revenues. The second shift occurs between the city and county when the city gets additional property tax revenue from the county and the county gets additional sales tax revenue from the city.

Table 2 City

Revenue Source	Current Revenue	Proposed vlf offset loss	Proposed Sales tax-property tax shift	Proposed Revenue
Property tax	$45,000	+ $8,000	+ $8,325	$61,325
Sales and use tax	55,500		- 8,325	47,175
VLF	3,800			3,800
VLF offset	8,000	- 8,000		0
Other *	57,000			57,000
Total	$169,300			$169,300

Table 3 County

Revenue Source	Current Revenue	Vlf offset loss	Sales tax-property tax shift	Proposed Revenue
Property tax	$120,000	+ $51,000	- $8,325	$162,675
Sales and use tax	80,000		+ 8,325	88,325
VLF	27,500			27,500
VLF offset	51,000	- 51,000		0
Other *	900,000			900,000
Total	$1,178,500			$1,178,500

* Other sources of revenue include local, state, and federal funds.

Background

"The fiscalization of land use" refers to the concept of examining land use decisions in the context of their revenue and expenditure consequences. Because Proposition 13 reduced the revenues that would be received from property taxes from any particular development (industrial, commercial, or residential), local jurisdictions began to pay even more attention to the fiscal outcomes of land use decisions, and those uses that generated revenues in addition to property taxes have been elevated in importance.

The decision by local governments to utilize land for retail sales in order to generate sales tax revenues is one example of the fiscalization of land use. Local governments have engaged in numerous activities to encourage retail activity in their jurisdiction, such as zoning excessively for retail, providing sales tax rebates to retailers who locate in their jurisdiction, waiving developer fees, and expediting the permit process.

This bill is intended to address, among other issues, the fierce competition that local entities are now facing in getting as much local (1.0%) sales and use tax revenue as they can.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author in an effort to protect local revenues, remove fiscal hurdles to housing, and reduce unbalanced land uses by modifying the influence of property tax and sales tax on local revenue decisions.
2. **Current revenues are unstable.** Important sources of revenue for local governments are the vehicle license fee (and VLF backfill) and local sales and use tax. However, these sources of revenue are volatile. VLF backfill requires an annual appropriation from the Legislature, which can make revenues uncertain for a local government when the state is facing a large budget deficit. Also, sales tax revenues can fluctuate based on the economy, which can make fiscal planning for local governments difficult.
3. **All local jurisdictions would be required to adopt a new ordinance.** Current law imposes a local tax at a rate of 1.25 percent in a county. A city may impose a local tax up to 1 percent, which is credited against the 1.25 percent tax in the county. Cities, counties, and redevelopment agencies must adopt an ordinance to impose a local tax, which outlines what rate the local jurisdiction receives. Many of the cities receive the full 1 percent allowed under current law, but some cities reach agreement with the county to take a smaller amount. For example, Angels Camp (0.88 percent), Hayward (0.95 percent), and Santa Rosa (0.975 percent) are some of the many cities that are allocated less than 1 percent currently. This bill would require every city, county, and redevelopment agency in the state to adopt new ordinances reflecting the new maximum rate of 0.85 percent.

4. **Some local jurisdictions may not receive local sales and use tax.** Some of the current county ordinances are referred to as a "shall ordinance" while others are referred to as a "may ordinance." A shall ordinance contains language providing that if only one city in the county fails or refuses to amend its ordinance, the county's ordinance *shall* become inoperative as well as all of the cities ordinances within that county. If that were to occur, the tax rate within the county would be reduced by 1.25 percent for at least one quarter and the county and cities within the county would receive no local sales and use tax revenue. Such an event did occur for three quarters in 1965 in Tehema County. A may ordinance substitutes the word "may" for "shall" which gives the county the discretion to make the county and city ordinance inoperative. By decreasing the maximum rate a city may impose, some counties with a "shall ordinance" may encounter problems in getting a new ordinance from the city and jeopardizing all local sales and use tax revenues allocated within the county.
5. **Department of Finance is required to make the necessary calculations.** This bill would require the Department of Finance to make the calculations regarding the property tax allocations and notify by October 1, 2002, each county auditor of the allocations required. However, the local sales and use tax rate for each city must be set by July 1, 2002. Some cities may be entitled to a rate that exceeds the 0.85 percent rate as of July 1, 2002, but the Department of Finance will not have completed the necessary calculations for the property tax allocations as of that date.
6. **Clarification of term is recommended.** This bill would provide that "on and after July 1, 2002, the maximum sales and use tax rate that may be imposed by a city" is 0.85 percent. This language is somewhat unclear as to whether this applies to existing city taxes or to new taxes only. It appears that the intent of the author is that this rate apply to all existing and future city taxes imposed. However, the use of the term "may be imposed" creates an ambiguity as it seems to refer to taxes imposed in the future rather than existing taxes. Clarification of this term would help local jurisdictions and the Board properly administer the provisions of this bill.
7. **Suggested technical amendment.** This bill would provide that the maximum local sales and use tax rate a city may impose would be 0.85 percent (rather than 1 percent as allowed under current law). This bill also provides if the additional property tax allocated to the city is insufficient to cover the sales tax lost that a city may impose a rate greater than 0.85 percent to the extent necessary to generate additional revenues in an amount that fully offsets the reduction. This provision could allow a city to impose a local sales and use tax rate that is unlimited. It is suggested that this amount should not exceed 1 percent (the amount allowed under current law).

8. **Increased administrative costs would be paid by all local jurisdictions.** The Board has an agreement with all the local jurisdictions in this state to collect and allocate the local sales and use tax. The jurisdictions pay the costs associated with the Boards administration of the local tax. This bill could increase those costs. The potential increased costs would be deducted from the revenue allocated to the jurisdictions within the state. It is unknown at this time the extent of the Board's costs associated with this bill.

9. **Related legislation.** Assembly Bill 680 (Steinberg) also contains provisions pertaining to local tax allocation. AB 680 would change the allocation method of the one percent local sales tax in El Dorado, Placer, Sacramento, Sutter, Yolo, and Yuba counties. AB 680 also provides that if a bill is chaptered that modifies the amount of property tax or VLF offset received by a city or county within the Sacramento region, the provisions of AB 680 would not become operative. Therefore, if AB 2878 were to become law, the provisions of AB 680 would not become operative. The Board has taken a neutral position on AB 680.

COST ESTIMATE

Modifying the local sales and use tax rate a city may impose would require every city to adopt a new ordinance and a new contract with the Board. Programming and data entry would also be necessary to modify the Fund Distribution System to account for different rates allocated to the various cities. A detailed cost estimate is pending.

REVENUE ESTIMATE

Revenue estimate is pending.

Analysis prepared by:	Bradley Miller	445-6662	03/22/02
Revenue estimate by:	Ron Ridley	445-0840	
Contact:	Margaret S. Shedd	322-2376	

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This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position